SUPREME COURT, U.S.

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NO. 1047

IN THE

Supreme Court of the United States

October Term, 1965

HOMER L. BRUCE, *Petitioner*,

v.

UNITED STATES OF AMERICA, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Homer L. Bruce

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Petitioner, Homer L. Bruce, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, entered in the above entitled and numbered case (No. 23,642 below) affirming the judgment of the District Court of the United States for the Southern District of Texas, Houston Division, adverse to petitioner.

CITATION TO OPINIONS BELOW

The opinion of the District Court (R. 103-113, Appendix A, hereto, p. 23) is reported in 254 F. Supp. 816. The Court of Appeals simply affirmed the judgment of the District Court in a per curiam opinion reading as follows (R. 117):

"PER CURIAM: We have carefully read the opinion and judgment of the trial court in this case, entered February 10, 1966, 254 F. Supp. 816. We find that it correctly states the legal principles controlling this suit for refund of taxes by appellant. We, therefore, AFFIRM the judgment of the trial court on the opinion of that court."

JURISDICTION

The judgment of the Court of Appeals, affirming the judgment of the District Court, was entered on January 10, 1967 (R. 119, Appendix B, hereto, p. 34). Jurisdiction of this Court is invoked under 28 U.S.C., section 1254(1).

STATEMENT CONCERNING THE RECORD

The record as certified by the clerk of the Court of Appeals and all original exhibits and nine copies of the printed record below are filed herewith. In addition, nine copies of Plaintiff's (petitioner's) Exhibits 1, 2 and 4 are filed herewith. Plaintiff's (petitioner's) Exhibit No. 3 is a unitization agreement of the West Bay Field in Plaquemines Parish, Louisiana, consisting of a 17 page contract, 16 pages of maps and 82 pages of statistics on 16 sands and 329 tracts and because of its length nine copies are not filed herewith.

QUESTIONS PRESENTED

A trust, Trinity Petroleum Trust, owns oil and gas royalties in 36 fields in 6 states. It owns the stock of a small company, Trinity Petroleum, Inc., which owns similar royalties in Louisiana. Both the Trust and Trinity Petroleum, Inc., are prohibited from acquiring any properties other than those acquired at their creation on October 1, 1951. Petitioner and his wife owned as community property

6,152 shares out of the 192,500 shares in the Trust. Petitioner's wife died in 1959 and left her shares to petitioner. The shares were valued at $37 per share for Federal estate tax purposes in her estate and under section 1014 of the Internal Revenue Code petitioner's basis for his shares is that $37 per share. For 1960, 1961 and 1962, the years involved in this case, the Government taxed petitioner on his part of the Trust's net royalty income less 27-1/2% depletion thereof and his portion of the Trust's income by dividends from Trinity Petroleum, Inc., with no allowance to petitioner of any deduction thereon under either section 167 or 611 of the Internal Revenue Code. The record is uncontradicted (1) that on those allowances by the Government petitioner will not recover his basis of $37 per share free of income tax, and (2) it is impossible for petitioner to determine what his allowances under sections 167 and 611 should be on a cost basis.

The questions presented are:

1. Were the courts below correct in holding that petitioner was restricted to the 27-1/2% depletion allowed to the Trust under section 613 when

(a) section 611 has always, since its original enactment in section 204(c)(2) of the Revenue Act of 1926, expressly provided:

> "In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section";

(b) the evidence is uncontradicted that on the basis of 27-1/2% depletion petitioner will never recover through such allowance his basis of $37 a share; and

(c) the evidence is uncontradicted that it is utterly impossible for petitioner to arrive at any figure for computing his cost depletion on 6152/192,500 of the income of the Trust from scattered royalties in 36 oil and gas fields in 6 states? Such a holding is in conflict with *Burnet v. Logan*, 283 U.S. 404, and with *Commissioner of Internal Revenue v. Tellier*, 383 U.S. 687, and cases cited therein that fundamentally the income tax law is to be applied so as to tax net income and not gross income.

2. Were the courts below correct in holding that petitioner is not entitled in reference to his shares in the Trust and through it his shares in Trinity Petroleum, Inc., to any deduction under section 167 of the Internal Revenue Code for the exhaustion of those shares, which are held for the production of income? This is contrary to the provisions of section 167 and *New York Life Insurance Co. v. Anderson*, 263 Fed. 527, holding that stock in a corporation is subject to an allowance for its exhaustion.

3. Were the courts below correct in holding that, because the market for shares in the Trust has been above petitioner's basis of $37 per share, petitioner's allowance for deductions is to be restricted to the 27-1/2% depletion allowed the Trust? Such a holding is entirely in conflict with *Fribourg Navigation Company, Inc. v. Commissioner of Internal Revenue*, 383 U.S. 272, and *Even Realty Co.*, 1 B.T.A. 355.

STATUTES INVOLVED

The applicable statutes are sections 167(a), 611 and 613 of the Internal Revenue Code as set forth in Appendix C hereto, page 35.

STATEMENT

The Court of Appeals stated per curiam that it agreed with the District Court's statement of the legal principles involved in this case. We will, therefore, deal with the opinion of the District Court. As that court's statement of the case was so inaccurate, we ask this Court to consider our own statement, which is amply supported by the record.

In 1937 Sherar and two others, who were oil men, formed Trinity Petroleum Company to buy oil and gas royalties. Sherar was the president, Beatty was the geologist, and petitioner was its attorney. From 1946 petitioner was its president and actively ran it. In 1951 it was desired to liquidate the Company and place the royalties in a trust. The Company's royalties were in 36 fields in Texas, Louisiana, Arkansas, Illinois, Indiana and Oklahoma. Their complexity is shown by petitioner's Exhibit No. 1 and the 20 maps attached thereto and the statement therein by petitioner, it being agreed that his statement would be accepted as testimony. (R. 70) Nine copies of that exhibit are filed with this Court. However, in Louisiana a trust could continue for only 10 years. A plan was worked out with the Government under which the Company organized Trinity Petroleum, Inc., a Texas corporation, with a small capital of 1,985. (R. 27-28) The Louisiana royalties were transferred to Trinity Petroleum, Inc., and the latter contracted to pay 95% of its income to the Company. (R. 35-39) On October 1, 1951, the Company transferred to the South Texas National Bank of Houston as Corporate Trustee, all the royalties in Texas, the stock of Trinity Petroleum, Inc., and its rights under the 95% contract. It transferred its royalties in the other four states to Arthur Trum, Individual Trustee, a trust officer of the

Bank, whose functions were merely to hold title to the royalties with the income going to the Corporate Trustee. The Bank as Trustee executed an Indenture of Trust under which it held all the property. The trust is generally referred to as the Trinity Petroleum Trust. The Company had 192,500 shares and it distributed to its stockholders the 192,500 shares in the Trust, with petitioner and his then wife receiving 6,152 shares.

The Commissioner by letter dated July 31, 1951, (R. 40-49) ruled (1) that the Trust would be taxable as a trust and not as an association, (2) that the 95% of the income from the Louisiana royalties paid by Trinity Petroleum, Inc., to the Trust would not be taxable to that Company, and (3) the Trust would be entitled to deduct depletion on that 95% income as well as the other royalties owned by the Trust itself.

The Trust Indenture is set out as Exhibit 1 to the pretrial stipulation, (R. 34) and nine copies thereof are filed with this Court. Article II thereof provides

> "No new or additional oil or gas royalties or properties of any other kind shall be acquired by the Trustees."

Paragraph 3 of the contract between Trinity Petroleum, Inc., and the Company (R. 37) provides that Trinity Petroleum, Inc., may not acquire any other properties or engage in any business except the ownership of the properties conveyed to it on October 1, 1951.

Petitioner's wife died in 1959 and bequeathed her half of the community property 6,152 shares to petitioner, and her shares were valued for estate tax purposes at $37 per share, which made petitioner's basis under section 1014 for the 6,152 shares $37 per share or $227,624.

Petitioner's suit is to recover income taxes paid by him for 1960, 1961 and 1962 on his income from the Trust. Paragraphs III-5 through III-10 of the complaint (R. 5-10) set out how Trinity Petroleum, Inc., and the Trust made their tax returns and how the taxable income of petitioner upon which he paid the taxes in controversy was determined. The facts set forth in those paragraphs are admitted by respondent's answer or in the stipulation. (R. 15 and 33) This may be illustrated as follows by using 1960.

Trinity Petroleum, Inc., showed its royalty income, (not including the part paid to the Trust under the 95% contract) deducted 27½% depletion and its expenses and paid Federal income tax on the balance. It had net cash for the year of $24,634.01 and paid a dividend to the Trust of $23,100 or 12¢ per share on the 192,500 shares.

The Trust showed that dividend and its royalties, deducted 27½% depletion on the latter and its expenses and showed the balance of $459,005.05 as its taxable income which it allocated to its certificate holders as dividend income of 12¢ per share and royalty income of $2.2644 per share. As its depletion deduction was not a cash reduction, it distributed to its certificate holders $648,725 in cash or $23,100 as dividends and $625,625 as royalties.

On the foregoing basis petitioner received for 1960 $738.24 as dividend income and $19,994.00 as royalty income, or a total cash of $20,732.24. However, the Government taxed him on $738.24 dividend income and $13,930.85 royalty income. This was taxation of a total of $14,669.09, which left him out of his cash of $20,732.24 only $6,063.15 to apply on his total basis of

$227,624 for his 6,152 shares. At this rate it would take petitioner 37½ years to recover his basis. Similarly, for 1961 the figure is 33.8 years and for 1962, 27.9 years.

Sherar, Beatty and petitioner all testified that it was impossible to determine any figure for petitioner to use for a cost depletion computation, and further that petitioner would not through the deductions allowed by the Government in this case ever recover his $37 per share tax-free, that is, he would be taxed on part of that $37 per share and would not be taxed upon his net income.

The position of the respondent is concretely stated by its attorney, Mr. Tyler, in the District Court as follows:

> "Mr. Tyler: * * *. Our position is 27½% is the maximum amount. It is our position the Revenue Code provides two methods of computing depletion, through a cost basis or through a percentage basis. Now, Mr. Bruce has alleged in his complaint that it is not possible to determine the total reserves which is necessary to determine cost depletion, so you can't determine it if you have to use percentage.
>
> * * *
>
> "Mr. Tyler: * * *. Now, it is our position that since these shares are traded in the active securities market here in the Houston area Mr. Bruce could have gone out at any time and sold his shares and recovered not only his basis but have made a gain, made a profit. * * *
>
> "Our position is the only deduction or exclusion from income would be the 27½% of the gross royalties." (R. 62-63)

The District Court sustained these positions of respondent and entered judgment denying petitioner any recovery.

REASONS FOR GRANTING THE WRIT

1. The action of the District Court in misinterpreting section 167 providing for reasonable allowance for the exhaustion of property held for the production of income, in holding that the 27½% depletion provision under section 613 is controlling even though the evidence shows that it will not return petitioner's basis, in holding that the general doctrine announced by this Court in *Burnet v. Logan*, 283 U.S. 404, is not applicable because there was a market value for petitioner's shares in the Trust, and in holding that petitioner is restricted to 27½% depletion because he could have sold his shares for more than his basis, contrary to the specific holding of this Court in *Fribourg Navigation Company, Inc. v. Commissioner of Internal Revenue*, 383 U.S. 272, and the case of *Even Realty Co.*, 1 B.T.A. 355, is so erroneous and will have such a far reaching effect on the whole area of law involved that this Court should hear this case and correct those erroneous holdings of the District Court.

Contrary to the statement by the District Court that petitioner relies entirely on *Burnet v. Logan, supra*, petitioner relies on the fundamental proposition consistently promulgated by the Congress and this Court, that the income tax laws are to be interpreted to levy a tax upon taxpayers' net income and not upon their gross income unless the Congress specifically provides to the contrary. This Court as recently as March 24, 1966, in *Commissioner of Internal Revenue v. Tellier*, 383 U.S. 687, said (p. 691):

> "We start with the proposition that the federal income tax is a *tax on net income*, not a sanction against wrongdoing. That principle has been firmly imbedded in the tax statute from the beginning. * * *

"With respect to deductions, the basic rule, with only a few limited and well-defined exceptions, is the same. During the Senate debate in 1913 on the bill that became the first modern income tax law, amendments were rejected that would have limited deductions for losses to those incurred in a 'legitimate' or 'lawful' trade or business. Senator Williams, who was in charge of the bill, stated on the floor of the Senate that

> " '[*T*]*he object of this bill is to tax a man's net income;* that is to say, what he has at the end of the year after deducting from his receipts his expenditures or losses.' "

After referring to *Commissioner v. Sullivan*, 356 U.S. 27, *Lilly v. Commissioner*, 343 U.S. 90, and *Commissioner v. Heininger*, 320 U.S. 467, this Court said (p. 693):

"Deduction of expenses falling within the general definition of § 162(a) may, to be sure, be disallowed by specific legislation, since deductions 'are a matter of grace and Congress can, of course, disallow them as it chooses.' *Commissioner v. Sullivan*, 356 U.S., at 28. The Court has also given effect to a precise and longstanding Treasury Regulation prohibiting the deduction of a specified category of expenditures; an example is lobbying expenses, whose nondeductibility was supported by considerations not here present. *Textile Mills Corp. v. Commissioner*, 314 U.S. 326, *Cammarano v. United States*, 358 U.S. 498. *But where Congress has been wholly silent, it is only in extremely limited circumstances that the Court has countenanced exceptions to the general principle reflected in the Sullivan, Lilly and Heininger decisions.*" (Emphasis added)

In *Commissioner of Internal Revenue v. Sullivan*, 356 U.S. 27, this Court in sustaining the right of a gambler

to deduct expenses incurred in conducting illegal gambling, said at page 29:

> "If we enforce as federal policy the rule espoused by the Commissioner in this case, we would come close to making this type of business taxable on the basis of its gross receipts, *while all other business would be taxable on the basis of net income. If that choice is to be made, Congress should do it.*" (Emphasis added)

Petitioner has never claimed that he will not receive through income from the Trust his full $37 per share. His position, supported by the uncontradicted evidence in this case, never challenged at any time by the Government, is that (1) the deductions allowed him by the Government will never equal his basis of $37 per share, (2) neither he nor anyone else can come to any figures for his cost depletion, and (3) the Government will be taxing him in part upon his gross income and not upon his net income. These facts have not yet been controverted by the Government and, therefore, we feel it unnecessary to set out in the body of this petition the evidence on those points. However, for the ready reference of the Court, we set it forth in Appendix D hereto, page 36.

Burnet v. Logan, 283 U.S. 404, is in all essential respects identical with this case. There were involved two interests in a contract that called for a mining company to pay 60¢ per ton for all ore mined from a single mine, which contract was owned by a company. Mrs. Logan and her mother sold their stock in the latter company and each received cash and a fractional interest in the 60¢ ton agreement. Mrs. Logan's mother died and left one-half of her interest to Mrs. Logan, which one-half was valued in her mother's estate at $277,164.50 for estate tax pur-

poses. Mrs. Logan claimed that it was so indefinite as to what she would receive under the 60¢ per ton agreement that she was entitled to recover her basis in the stock of the company sold as to her first interest and the estate valuation of $277,164.50 as to the interest inherited from her mother, before being held to have received any taxable income. This Court held with her on both points. The Government introduced detailed estimates as to what she would recover and what percentage would represent taxable income, but this Court rejected all of this evidence. In the present case the Government did not even attempt to furnish any such estimates. As to the interest inherited from her mother, which is exactly like the interest that petitioner has in these shares in the Trust, this Court said on pages 413-414:

> "From her mother's estate Mrs. Logan obtained the right to share in possible proceeds of a contract thereafter to pay indefinite sums. The value of this was assumed to be $277,164.50 and its transfer was so taxed. *Some valuation—speculative or otherwise—was necessary in order to close the estate.* It may never yield as much, it may yield more. If a sum equal to the value thus ascertained had been invested in an annuity contract, payments thereunder would have been free from income tax until the owner had recouped his capital investment. We think a like rule should be applied here." (Emphasis added)

The rule in *Burnet v. Logan* has been specifically held by the Government to be applicable to oil and gas royalties,[1] and there are many cases applying the rule.[2]

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1. G.C.M. 9798, X-2 C.B. 221; G.C.M. 11473, XII-1 C.B. 91; G.C.M. 11822, XII-1 C.B. 229.

2. Among which cases see **Helvering v. Drier**, 79 F.2d 501 (4 CCA); **Axe v. United States**, 191 F.Supp. 671; **Inaja Land Company, Ltd.**, 9 T.C. 727; **Anton L. Trunk**, 32 T.C. 1127. See **Mertens Law of Federal Income Taxation**, § 5.02, pp. 22-23, Footnote 71.

The only place where market value came into play in *Burnet v. Logan* was in connection with the first situation cited above where Mrs. Logan sold some of her shares and got cash and an interest in the 60¢ per ton royalty agreement. This Court said that in such a case she would be entitled to recover her basis before having any tax *because this was not a closed transaction since there was no market for the interest in the 60¢ per ton royalty that she received.* This Court said at page 413:

> "Nor does the situation demand that an effort be made to place according to the best available data some approximate value upon the contract for future payments. This probably was necessary in order to assess the mother's estate. As annual payments on account of extracted ore come in they can be readily apportioned first as return of capital and later as profit. *The liability for income tax ultimately can be fairly determined without resort to mere estimates, assumptions and speculation.* When the profit, if any, is actually realized, the taxpayer will be required to respond. The consideration for the sale was $2,200,000.00 in cash and the promise of future money payments wholly contingent upon facts and circumstances not possible to foretell with anything like fair certainty. The promise was in no proper sense equivalent to cash. *It has no ascertainable fair market value. The transaction was not a closed one.*" (Emphasis added).

Commissioner of Internal Revenue v. Carter, 170 F.2d 911, is the only type of case where market value comes into play. A corporation with a large number of brokerage contracts calling for payment to it of 1¢ per barrel on all oil to be sold to various parties under certain contracts, was dissolved by the sole stockholder, who received its rights to these brokerage payments. The court held on the strength of the above statement in *Burnet v. Logan*

that, since the brokerage contracts had no ready market value, *the liquidation was not a closed transaction* and all the money the stockholder would receive thereafter on the brokerage contracts would be on the basis of capital gains.[3] On the other hand, if they had had a ready market value and it had exceeded the stockholder's cost of the stock, such excess would have been taxed as a capital gain and the receipts thereafter under the brokerage contracts would have been ordinary income. Therefore, it is clear that under *Burnet v. Logan* the fact that there was a market value for petitioner's shares in the Trust has no bearing upon the present case.

But both the Government and the District Court say that the provision for 27½% depletion under section 613 is the complete answer and by it Congress intended to resolve all these uncertainties. For example, the District Court said:

> "Production from a single oil or gas well presents much the same difficulties of capital-income allocation as does Trust's 'many, many tracts in 36 fields in 6 different states.' The difficulties are both technical (how much oil reserve exists) and conceptual (whether the production of oil is a mere conversion of capital investment or an income producing operation). Congress resolved these difficult problems by providing the 27½% depletion allowance; 27½% of the oil or gas produced is not subject to taxation. The figure is arbitrary and represents a concession to the capital conversion aspects. (R. 109)
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> * * *

3. Similar cases on such sales or liquidations are **Westover v. Smith**, 173 F.2d 90 (9 CCA); **McDonald v. United States**, 181 F. Supp. 332 (Washington); **Estate of Raymond T. Marshall**, 20 T.C. 979; **J. C. Bradford**, 22 T.C. 1057; **George J. Lentz**, 28 T.C. 1157; and **Frank H. Hoy**, 17 T.C.M. 115. The Commissioner has acquiesced in the **Carter** case. Rev. Rul. 58-402, 1958-2 C.B. 15.

> "However, plaintiff disputes something different, whether 27½% depletion will ever reduce his basis to zero. This does not bring Logan into play and only speaks to the proper apportionment of capital return and income. Plaintiff asserts that this alleged uncertainty entitles him to treat all revenues as returns of capital until he recovers his basis. Section 613 provides that this uncertainty is resolved by the arbitrary allocation of 72½% income, 27½% principal." (R. 110)

The slightest knowledge of section 613 and its history refutes the position of the Government and of the District Court. In Appendix E hereto we set out the history of the provisions dealing with depreciation and depletion. The 27½% depletion was enacted for the first time in the 1926 Act and, as shown in Appendix E hereto, p. 43, section 204(c)(2), providing for the 27½% depletion, expressly stated

> "except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

As shown in that appendix, the report of the Senate Finance Committee on the 1926 Act stated that it was enacted merely to get around the difficulty of administering the discovery provisions dealing with depletion. It stated:

> "The administration of the discovery provision of existing law in the case of oil and gas wells has been very difficult because of the discovery valuation that had to be made in the case of each discovered well. In the interest of simplicity and certainty in administration your committee recommends that in the case of oil and gas wells the allowance for depletion shall

> be 25 per cent of the gross income from the property during the taxable year."

In the conference this was raised to 27½%.

In the regulations under the 1926 Act, the Commissioner said in Regulations 69, Art. 1602(2), providing for the 27½% depletion:

> "In no case shall the deduction for depletion with respect to oil and gas wells be less than it would be if computed without reference to section 204(c)(2) of this paragraph."

Section 611 provides that there shall be allowed a reasonable allowance for depletion. Section 613 dealing with percentage depletion provides that the allowance under section 611 shall not be less than it otherwise would be if section 613 were not in the law.

It is clear that petitioner is not limited to the depletion of 27½% taken by the Trust on its royalty income.

2. Petitioner claims that in addition to the depletion allowance under section 611 and the rule under *Burnet v. Logan*, he is expressly allowed a deduction under section 167 for the exhaustion of his shares in the Trust and of his indirect interest in the shares in Trinity Petroleum, Inc. As shown in Appendix C hereto, page 35, section 167 allows the deduction for the exhaustion of property held for the production of income. Prior to 1942 and the decision by this Court in *Higgins v. Commissioner of Internal Revenue*, 312 U.S. 212, such a deduction for exhaustion could be taken only for property used in a trade or business. Congress by section 121 of the Revenue Act of 1942 extended this provision to "property held for

the production of income." Certainly the shares in the Trust and petitioner's indirect interest through the Trust in shares in Trinity Petroleum, Inc., are held for the production of income.

The District Court missed the entire point under section 167 when it stated (R. 110):

> "Plaintiff also complains that he is allowed no depletion on his receipts from the dividends of Inc. *Inc. is allowed depletion on its royalties.* Plaintiff cites no authority that a shareholder is entitled to depletion or depreciation of any kind on the assets of a corporation, * * *." (Emphasis added)

Petitioner, of course, has never claimed he is entitled to any depletion or depreciation in reference to the assets of Trinity Petroleum, Inc., but he does assert he is entitled to a deduction for the exhaustion applicable to his indirect stock interest in Trinity Petroleum, Inc. As pointed out above, neither the Trust nor Trinity Petroleum, Inc., may acquire any properties other than those conveyed to them on October 1, 1951, at their creation. Their assets consist of oil and gas in the ground which is being exhausted. However, with reference to the income from dividends on the stock of Trinity Petroleum, Inc., the Government is taxing petitioner on all of those dividends with no deduction whatsoever. On that basis, petitioner will pay income taxes on all his receipts of those dividends and never recover any part of his basis applicable to them.

The District Court apparently put great emphasis on the fact that Trinity Petroleum, Inc., was allowed depletion on its income for it said, as above shown:

> "Inc. is allowed depletion on its royalties."

The fact that Trinity Petroleum, Inc., is allowed the depletion is of no benefit to petitioner. It merely increases the dividends that he would otherwise receive but does not allow him any deduction on account of those dividends.

In the minds of some it seems that they think that depreciation allowances apply only to physical properties. This is completely wrong. For example, as early as Regulations 69 under the Revenue Act of 1926, Art. 163 provided

> "Art. 163. Depreciation of intangible property—Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance."

As early as 1925 the Board of Tax Appeals pointed out that the word "depreciation" disappeared from the Revenue Acts after that of 1913.[4]

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4. In **Even Realty Co.**, 1 B.T.A. 355 (1925), the Board said at page 361:

"But it should be noted that the word **depreciation** has disappeared from the revenue acts. Presumably the change was made by Congress in an effort to perfect the language of the statute. The act of 1909 said 'a reasonable allowance for depreciation of property, if any.' The Revenue Act of 1913 restricted the deduction to an allowance for depreciation **by use, wear, and tear.** And the later revenue acts eliminated the word **depreciation** entirely (see p. 359, **supra**). There is nothing in any of the revenue acts subsequent to the Sixteenth Amendment which would have precluded the taxpayer from taking a reasonable deduction for **wear and tear** upon its building, even though the building itself might have appreciated in value at the same time.

"Depreciation in its broad sense, like appreciation, may be due to extrinsic causes, but that is not true of **wear and tear.** There is no reason why **wear and tear,** purely intrinsic matters, need be tied up to **appreciation** resulting from extrinsic causes. The two can go on simultaneously and no provision of law requires the one to be offset against the other. The

In reference to the statement of the District Court that no case has ever held that a stockholder was entitled to a deduction for exhaustion of stock in a corporation, the Court of Appeals for the Second Circuit as early as January 14, 1920, in *New York Life Insurance Co. v. Anderson*, 263 Fed. 527, held that taxpayers who own stock in corporations may take deductions for their depreciation. Petitioner cites that case only to show that it has been held that stock in corporations may be exhausted and the holder is entitled to a deduction on account thereof, but frankly petitioner doubts that this Court would apply the method in computing this exhaustion followed by the court in the case cited.

3. The District Court's holding adverse to petitioner on the ground that there was a market for his shares in the Trust greater than his basis is directly in conflict with *Fribourg Navigation Company, Inc. v. Commissioner of Internal Revenue*, 383 U.S. 272. (As the *Fribourg* case was decided March 7, 1966, and the District Court decided this case on February 2, 1966, it did not have the advantage

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revenue acts do not contemplate the annual computation of appreciation for the purpose of taxing the increase of value represented thereby—they expect appreciation to be accounted for entirely and exclusively at the final disposition of the property. **This is quite logical, for an appreciation due to extrinsic circumstances, such as general market changes, is very likely to be offset by a corresponding reduction in value because of similar extrinsic causes in a later period,** while the property is still held by the same owner; and it would obviously be highly inconvenient if not impossible, as well as unfair, to require every taxpayer to appraise all his capital assets at the end of every year for the purpose of seeing whether there were any net appreciation in value during the year and of taxing him thereon. But **exhaustion** and **wear and tear** are due wholly to intrinsic causes—the nature of the asset. They are not offset by any other intrinsic causes." (Emphasis added)

of this Court's opinion in the *Fribourg* case and that probably accounts for its decision being in conflict with the rule announced by this Court in that case.)

The District Court said (R. 111):

> "The market prices also perform a second and distinct role. They provide a means by which plaintiff can certainly recover his basis. Plaintiff can sell his shares."

The District Court in that decision went directly contrary to the fundamental statement by this Court in the *Fribourg* case:[5]

> "By tying depreciation to sales price in this manner, the Commissioner has commingled two distinct and established concepts of tax accounting—depreciation of an asset through wear and tear or gradual expiration of useful life and fluctuations in the value of that asset through changes in price levels or market values."

It is interesting to note that the Board of Tax Appeals as early as 1925 in *Even Realty Co.*, 1 B.T.A. 355, pointed out the fundamental difference between depreciation and appreciation as shown by the quotation from that Board's opinion in Footnote 4, page 18 hereof. It shows the fundamental error into which the District Court fell in this case in deciding it against the petitioner on the basis of this so-called market value.

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5. Just contrary to the action of the District Court in this case the **Fribourg** case has been widely followed by other courts. **Sheppard v. U. S.**, 361 F.2d 972 (Ct. of Claims); **U. S. v. Kimball Gas Products Co.**, 358 F.2d 133 (5 CA); **U. S. v. Wyoming Builders, Inc.**, 358 F.2d 672 (10 CA); **Shepherd v. U. S.**, 66-1 U.S.T.C. ¶9458 (Dist. Ct. Ala.); **John Town, Inc.**, 46 T.C. 107; **Catherine F. Dinkins**, 45 T.C. 593.

CONCLUSION

Petitioner suggests that there is one simple answer to the position of the District Court and the Court of Appeals that the 27½% depletion provision is absolutely controlling. As is well known, there has been for many years a concerted attack on the figure of 27½%. Many opponents propose to reduce it to 10%, but let us suppose that the figure had always been 15% instead of 27½%. On the basis of 15% petitioner's income from the 6,152 shares would have to total $1,517,493.33 for him to recover his basis of $227,624, which would mean that the total production from the Trust royalties would have to be $47,483,333.18, which figure is, of course, ridiculous to contemplate. Yet, we do not know but what the depletion percentage will be reduced to 15% or even less.

Petitioner respectfully prays that this petition for writ of certiorari be granted.

Respectfully submitted,

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